Federal Credit Activities: An Overview of the President's Credit Budget for Fiscal Year 1983

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CONGRESS OF THE UNITED STATES CONGRESSIONAL BUDGET OFFICE

FEDERAL CREDIT ACTIVITIES:

AN OVERVIEW OF THE PRESIDENT'S

CREDIT BUDGET

FOR FISCAL YEAR 1983

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Details in the text and tables may not add to totals because of rounding.

Unless otherwise indicated, 1982 and 1983 figures are Administration estimates.

All Administration estimates in this report are from The Budget of the United States Government, Fiscal Year 1983 (February 1983) and Office of Management and Budget data.

PREFACE

This overview of the Administration's 1983 credit budget was prepared at the request of the House and Senate Budget Committees. It is intended to supplement the budget documents by bringing together in one place information on the credit budget. The paper reviews major proposed changes in federal credit activities for 1982 and 1983 and presents a function-by-function examination of the Administration's credit program estimates.

The paper was prepared by CBO's Budget Process Unit. Richard P. Emery, Jr., with the assistance of Deirdre B. Phillips, wrote the first three chapters. Deirdre B. Phillips, Michael Margeson, and Mitchell I. Mutnick wrote Chapter IV. The authors greatfully acknowledge the helpful comments of CBO's cost analysts and Martin D. Levine and Marvin M. Phaup of CBO; Susanne V. Slater of the Office of Management and Budget; Edward Brigham and Sandy Pianalto of the House Committee on the Budget; and Robin Seiler, David Nummy, Ann Hadley, and Susan Petty of the Senate Committee on the Budget. Patricia H. Johnston edited the manuscript which was typed for publication by Paula Gatens and Nancy E. Wenzel.

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SUMMARY

The President's budget for 1983 includes recommendations for total new direct loan obligations and total new loan guarantee commitments. It also recommends appropriations limitations for individual credit programs. Together, these requested credit aggregates and program limitations comprise the President's credit budget for 1983.

The credit budget was established to provide a rational structure for the consideration of the total size and allocation of federal direct loan and loan guarantee programs. In recent years, federal credit activities have grown rapidly. It is important to control these activities because they potentially can change the allocation of credit among uses, the composition of economic activity, and the economy's growth rate. The unified budget is a cash-flow budget, designed to present an accurate view of the federal government's effects on aggregate demand. As such, it includes only net credit--that is, only those credit programs that affect the government's cash flow--rather than total lending. The credit budget includes all credit activities on a gross basis to highlight the impact of credit activities on capital markets.

THE PRESIDENT'S CREDIT BUDGET

The Administration's credit budget for 1983 continues the efforts initiated with its 1982 budget to reduce federal credit activities as a means of reducing federal presence in capital markets. The 1983 credit budget proposes \$49.0 billion in new direct loan obligations, \$98.4 billion in new primary loan guarantee commitments, and \$38.4 billion in secondary loan guarantee commitments. The 1983 request for direct loans is 19 percent below the 1982 base level; the request for primary loan guarantees is 6 percent below the base; and the request for secondary guarantees is 44 percent below the base (see the Summary Table). 1/

1/ The 1982 base figures are the estimates for the credit budget used by the Congress in the first session of the 97th Congress. The 1982 base is used here to provide a comparison to credit budget levels prior to adjustment for the Administration's current year policy changes.

SUMMARY TABLE. TOTAL CREDIT BUDGET (By fiscal year, in billions of dollars)

Credit Activity	1981 Actual	1982 Base a/	Administration Estimates 1982	Administration Estimates 1983
Direct Loan Obligations				
On-budget	40.9	42.7	39.9	31.8
Off-budget	31.5	31.3	29.6	25.5
Gross Direct Loan Obligations	72.4	73.9	69.5	57.3
Less FFB sales of loan assets	-15.2	-13.5	-13.2	-8.3
New Direct Loan Obligations	57.2	60.5	56.4	49.0
New Loan Guarantee Commitments	152.7	205.7	166.1	161.4
Less				
Secondary loan guarantees	-44.1	-68.8	-48.7	-38.4
Guaranteed loans held as direct loans				
FFB	-30.3	-30.0	-28.5	-24.7
GNMA	-1.8	-2.0	-1.9	---
New Primary Guarantees	76.5	104.9	87.1	98.4
Credit Budget Total	133.7	165.4	143.4	147.3

SOURCE: The Administration estimates are taken from the Budget of the U.S. Government, Fiscal Year 1983, Part 3, p. 3-24; 1982 base figures are taken from CBO's Credit Budget Scorekeeping System.

a/ Adjusted to reflect full principal for loan guarantees rather than contingent liability, an increase of $17.1 billion in primary guarantees.

The proposed reductions are to be accomplished by shifting to other forms of support, restricting eligibility, reducing lending levels for some programs, and terminating lending in 1983 for others. The Administration's budget assumes that synthetic fuels development will be supported through price guarantees rather than loan guarantees. Savings and loan institutions will be supported by capital contributions and assistance in mergers rather than direct loans by the Federal Savings and Loan Corporation. Small Business Administration surety bond guarantees are considered to be a form of insurance rather than guarantees for lending. The Administration proposes to reduce federal housing assistance in several ways:

- Narrowing eligibility criteria for Federal Housing Administration mortgage guarantees;

- Reducing the Government National Mortgage Association's (GNMA) mortgage-backed securities and eliminating the GNMA tandem plan program;

- Eliminating rural housing insurance support for self-help housing and sharply reducing single- and multi-family housing; and

- Shifting from construction support for low-income public housing to a system of rental vouchers.

In addition to the above reductions, no new loans are proposed for direct loans to students, most transportation loan programs, loan guarantees for community development, and economic development programs.

Increases have been proposed for a small number of loan programs, primarily in the area of international security. The Administration requests that foreign military sales credit direct loans be increased by $1.2 billion to $1.7 billion. The request for direct loans to foreign countries through the economic support program is $895 million, over a 400 percent increase from the 1982 base level.

The Administration's 1983 proposed $49.0 billion for direct loan obligations far exceeds the amount that will actually be obligated as new direct loans by federal agencies. Lending for new activities will be limited to $23.5 billion, or 48 percent, of the proposed total. New direct loan obligations will be distributed as follows:

Distribution of 1983 Direct Loan Obligations
(In billions of dollars)

Purpose	Estimate	Percent
New Direct Loans	23.5	48
Direct Loans to Repay Guarantee Claims	2.3	5
Direct Loans to Repurchase Loan Assets	6.8	14
Agency Guaranteed Loans Held as Direct Loans by the FFB	16.4	34
Total	49.0	100

Support to farmers through the Commodity Credit Corporation and the Farmers Home Administration will account for $15.5 billion in direct loan obligations for new activities. International assistance and aid to U.S. exporters will amount to another $7.6 billion.

CONGRESSIONAL ACTION ON THE 1982 CREDIT BUDGET

The 1982 concurrent budget resolution set targets for direct loans and primary and secondary loan guarantees. The Administration revised request for direct loans for 1982 is $56.4 billion, 9 percent over the 1982 target. The difference is caused primarily by reestimates of financing transactions. The Administration's 1982 revised requests for primary and secondary guarantees are substantially below the targets. The revised request for primary guarantees is $98.4 billion, $3.8 billion below the resolution target after the target has been adjusted to a comparable accounting basis. (A shift from the contingent liability of the government used in the concurrent resolution to full principal of the loans guaranteed adds $17 billion to the target.) The revised request for secondary guarantees is $22.6 billion below the target. The differences between the target and the 1982 revised requests result both from the Administration's proposed cuts and from reestimates because of changed economic conditions.

The Congress enacted appropriations limitations for 1982 on 38 percent of total direct loan obligations and 73 percent of total loan guarantees, almost all of the limitations proposed by the Administration in its July request. Proposed limitations were not enacted for development assistance and economic support programs, for the Small Business Administration's programs, or for the federal ship financing program. Program levels for each of these programs were determined either by appropriations of budget authority or by the loan program authorizations. In three cases, the Congress enacted appropriations limitations for programs for which the Administration had proposed no new funding: the Overseas Private Investment Corporation, National Consumer Cooperative Bank, and the college housing program. For 1983, the Administration has proposed that essentially the same programs be exempt from limitation that have been exempted previously--namely, entitlements and mandatory programs, such as CCC price supports, guaranteed student loans, and veterans' mortgage guarantees; financing transactions of the FFB; and direct loans disbursed to cover default claims.

The final continuing resolution (Public Law 97-92) included an amendment to make limits established in appropriations bills into mandatory program levels, except in those programs for which there are insufficient qualified borrowers. The amendment was prompted by the Administration's November 5, 1981 announcement of proposed administrative reductions in credit programs below levels established in appropriations bills. The Administration's 1982 revised requests for additional limitations responded to this requirement.

CHAPTER I. THE NEED FOR A CREDIT BUDGET

The U.S. government provides credit to assist a wide array of activities. The amount of new credit extended under federal auspices now constitutes a significant share of all new credit advanced in the economy each year. The credit budget was established to provide a rational structure for the consideration of the total size and the allocation of federal direct loan and loan guarantee activities. This step was prompted by concern over the size and growth of federal credit, the consequences of it effects on the economy, and the realization that the budgetary treatment of credit programs was less rigorous than that of direct spending or taxes. The credit budget, which estimates new direct loans and loan guarantees for each fiscal year, attempts to correct the understatement of federal credit activities in the unified budget.

SIZE AND GROWTH OF FEDERAL CREDIT

The federal government extends credit in two basic forms: direct loans and loan guarantees. 1/ Federal agencies make direct loans to individuals, businesses, nonprofit organizations, and local governments for a variety of purposes, almost always at subsidized interest rates. For example, the Department of Housing and Urban Development lends directly to nonprofit sponsors, consumer cooperatives, and certain public agencies to construct rental housing for elderly and handicapped persons. In a loan guarantee, the federal government pledges to repay principal--in whole or in part--and interest on a loan in case of default by the borrower, thus reducing the lender's exposure to risk. No federal expenditures are involved unless the borrower defaults. The Federal Housing Administration, for example, guarantees or insures repayment of home mortgages extended to qualified homebuyers by savings and loans and other financial institutions.

Federal credit activities are growing rapidly, as can be shown by several measures. These include the growth of net federal credit, the proportion of domestic credit accounted for by federal activities or the "federal participation rate," and the outstanding loans issued under federal auspices.

1/ See the Glossary of Federal Credit Budget Terms in Appendix A.

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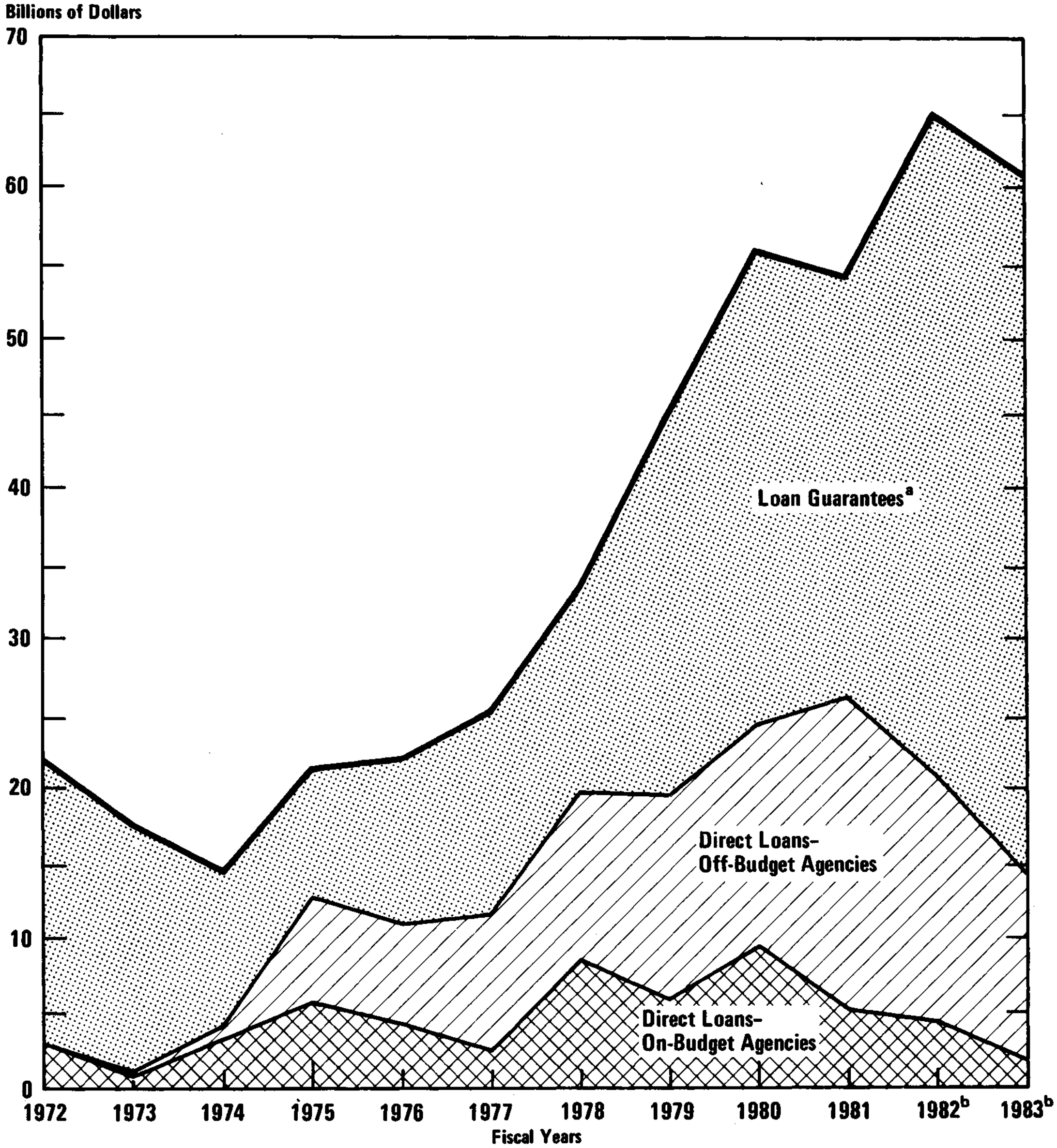
The growth in net federal credit--new direct lending by both on- and off-budget agencies and new loans guaranteed less repayments--is shown in Figure 1. In recent years, the volume of new direct loans and new loans guaranteed has grown rapidly. Annual net direct lending rose from $4.1 billion in 1974 to $26.1 billion in 1981, an increase of over 500 percent. Most of the growth in direct loans occurred in lending by off-budget agencies, whose activities are excluded from the unified budget totals. Net loans guaranteed annually rose from $10.3 billion in 1974 to $28.0 billion in 1981, an increase of 172 percent. Under the Administration's proposals, net federal lending is estimated to decrease by 6 percent between 1982 and 1983 as a result of proposed reductions in overall federal credit and the expectation of increased repayments.

The federal government participates in domestic credit markets both as a lender and a borrower. It acts directly as a lender through federal loan and loan guarantee programs, the activities covered by the federal credit budget. It also affects credit markets indirectly through the lending activities of privately owned, government-sponsored enterprises, such as the Federal National Mortgage Association. The federal government borrows to support its operations. It borrows directly through the Treasury to finance on- and off-budget deficits; it participates indirectly as a borrower by guaranteeing loans of other borrowers and through the borrowing of government-sponsored enterprises.

Federal participation rates have grown steadily from 1974 to 1981. Federal direct and guaranteed lending as a percentage of all credit extended in the United States has grown from 8 percent to 13 percent in this period. If the lending of government-sponsored enterprises is added to these federal activities, the government was involved in 21 percent of all domestic lending in 1981. Federal participation in domestic credit markets as a borrower has increased from 7 to 26 percent from 1974 to 1981. Most of this growth has been in federal borrowing from the public to fund budget deficits. The addition of the borrowing of government-sponsored enterprises results in combined direct and indirect federal participation of 35 percent of all funds borrowed in domestic credit markets in 1981.

Another measure of the growth of federal credit is outstanding loans issued under federal auspices (see Figure 2). The Administration estimates that total loans outstanding will exceed $900 billion by the end of 1983. In the decade between 1974 and 1983, outstanding loans will have increased 217 percent. Any year in which there is positive lending, total outstanding loans increase. The outstanding loans represent the growing contingent liability of the government. Based on past experience, over 95 percent of these loans will ultimately be repaid.

Figure 1.
Components of Net Federal Credit, Fiscal Years 1972-1983

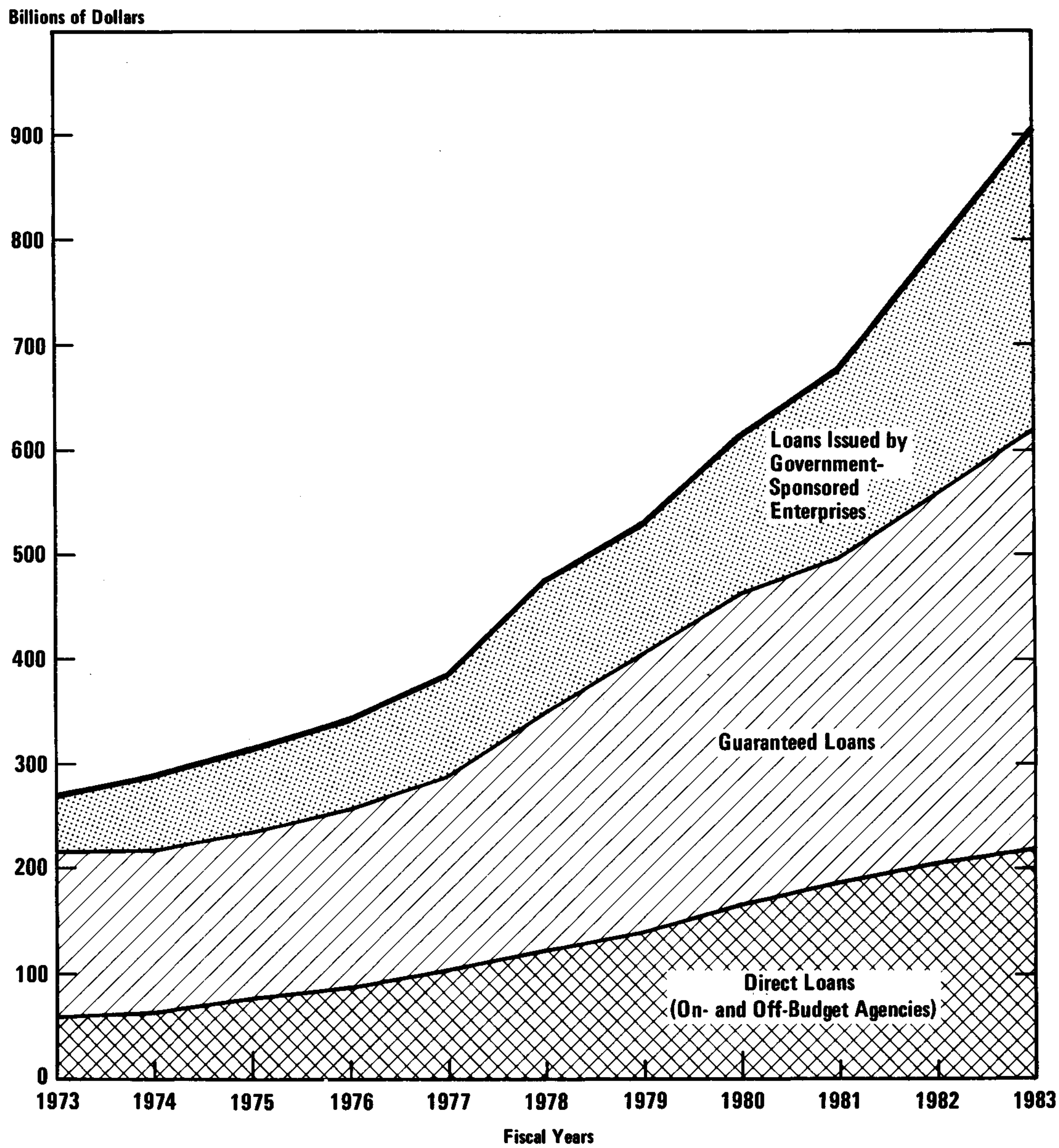


[a] Primary guarantees: excluding secondary guarantees and guaranteed loans acquired by on- and off-budget agencies.
[b] Estimates

SOURCE: *Budget of the United States Government, Fiscal,Year 1983,* Special Analysis F, Federal Credit Programs.

Figure 2.

Outstanding Loans Issued Under Federal Auspices



SOURCE: *Budget of the United States Government, Fiscal Year 1983,* Special Analysis on Federal Credit Programs.

ECONOMIC EFFECTS OF FEDERAL CREDIT

Control of federal credit activities is important because these programs can potentially change the allocation of credit among uses, the composition of economic activity, and the economy's growth rate. Federal credit also consumes scarce budget resources by providing substantial subsidies to some borrowers.

In the absence of government intervention, credit and investment resources flow into those uses in which rates of return, adjusted for risk, are perceived to be highest. Enterprises facing low prospective rates of return receive little credit in private markets. The government may intervene to change this allocation if it believes market perceptions of profitability and risk are wrong, or if it believes the market fails to take into account significant social costs and benefits of some activities.

In its direct loan programs, the federal government utilizes its premier standing in the credit markets to borrow at a risk-free rate and lend to selected borrowers at a lower rate than the borrowers could have obtained on their own. If the government loan goes to a borrower who would not have otherwise obtained the funds, another potential borrower may be denied credit or "crowded out" of the market by the government program. The key element in assessing the economic effects of such a reallocation of credit is to determine which borrower, the selected one or the one crowded out, would use the funds more productively.

Loan guarantees are similar in effect to direct loans. By assuming a large share of default risk, the government can direct resources to uses that would otherwise be regarded as too risky to qualify for financing. A federal loan guarantee does not reduce the real risk involved in a project or activity. Instead, it shifts the burden of risk from lenders to taxpayers. Crowding out of unguaranteed, but less risky borrowers, can occur, and the net effect on productivity and economic growth will depend on the relative value of the supported and unsupported activities. In fact, most federal financial assistance has been directed toward increasing the flow of credit into housing, agriculture, and troubled industries with low earnings.

Federal credit delivers substantial subsidies to some borrowers. When a federally sanctioned borrower who otherwise would pay 16 percent interest in private credit markets obtains funds at 6 percent, the federal government is providing a subsidy equal to 10 percent of the principal for each year the loan is outstanding. Interest rates for most direct loan programs are specifically set by law or result from formulas set by law. The Office of Management and Budget (OMB) estimates that, during 1983, newly committed loans and loan guarantees will provide interest subsidies to borrowers with a total present value of $14 billion. 2/

CREDIT IN THE BUDGET PROCESS

Credit in the Unified Budget

Despite its large volume, federal credit activity appears to be small in the unified budget. For example, net on-budget direct lending, the only portion of the credit budget included in the unified budget totals, accounted for less than 1 percent, or $5.2 billion, of outlays in 1981. The reason for the inclusion of only net credit in the unified budget is that the unified budget is a cash-flow budget. It is designed to present an accurate view of the federal government's effect on aggregate demand. Net lending by on-budget agencies is not, however, an adequate representation of the amounts of new credit extended each year by the federal government. It understates new credit extensions in three respects.

First, most direct lending is extended by off-budget agencies, whose activities are excluded by law from the unified budget totals. Net off-budget direct loans were $20.9 billion in 1981, compared to on-budget loans of $5.2 billion. These off-budget direct loans are similar to on-budget loans in every respect except that they are financed mainly by the off-budget Federal Financing Bank (FFB). They are primarily attributable to loan guarantees provided by the Farmers Home Administration, the foreign military sales credit program, the Rural Electrification Administration, and the Tennessee Valley Authority. These agency loan guarantees are converted to direct loans through FFB financing.

Second, budget authority is not recorded in the amount of loan guarantees. Since the unified budget is a cash-flow budget, cash disbursements and budget authority are not required unless a default occurs. A cash-flow budget cannot measure contingent liability or the volume of loan guarantees, but only the amount of money needed to cover defaults.

2/ Budget of the United States Government, Fiscal Year 1983, Special Analysis F, pp. 50-57.

Third, even when the unified budget records agency direct loan activities--again because it is a cash-flow budget--it obscures the actual volume of new credit channelled through the programs by subtracting repayments of old loans from the amount of new loans. For example, in 1980 the Commodity Credit Corporation extended almost $6 billion in loans to farmers. Repayments on loans extended in earlier years were even higher, however, so that the net loan outlays recorded in the budget were negative.

The Credit Budget

The credit budget totals seek to correct the shortcomings of the unified budget in presenting the allocative effects of federal credit assistance. The credit budget includes all new credit activities of the government on a gross basis: on-budget direct loans, off-budget direct loans, and loan guarantees. It does not, however, include activities of government-sponsored credit enterprises, which are not subject to annual budget oversight. Activity is recorded at the point of obligation or commitment for credit, rather than at the point when loans are actually made, because the obligation level is the point at which the Congress can exert some control.

In addition to focusing attention on the total level of federal credit activities, the credit budget improves control of individual programs. Specific limitations may be set on the authority of agencies to enter into new obligations.

The credit budget, as is the case with the unified budget, is initially submitted as a proposal of the President. The Administration's credit budget recommends both aggregate credit levels and specific proposals for individual programs. The Congress can act on the credit budget in two ways. First, in its concurrent budget resolutions, the Congress can set targets for total new credit activity. Second, the Congress can include limitations on new direct loan obligations and new loan guarantee commitments by program in appropriations bills. The credit budget gives the Administration and the Congress the means to exercise greater oversight of federal credit. Complete control of federal credit growth will only be achieved, however, when credit budgeting has become an integral part of the budget process, and when the allocation of resources through credit is considered as carefully as the allocation through direct spending.

Information on the credit budget is available from several sources within the President's budget documents. Part 5 of the budget provides function by function discussion of the Administration's requests, including proposals effecting federal credit. Special Analysis F, "Federal Credit